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CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 646

FLORA REGENSBURG, as Executrix of the Estate of Jerome Regensburg, Deceased,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

No. 647

MELVILLE E. REGENSBURG,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

No. 648

MORTIMER REGENSBURG,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

No. 649

ISAAC REGENSBURG,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

No. 650

MELVILLE E. REGENSBURG and SOPHY P. REGENSBURG,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

Arthur B. Hyman,
Counsel for Petitioners.

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PETITION FOR WRITS OF CERTIORARI

MAY IT PLEASE THE COURT:

The petition of the above named petitioners respectfully shows to this Honorable Court:

Jurisdiction

The statutory provision believed to sustain jurisdiction is Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (Chapter 229, Section 1, 43 Stat. 938).

The cases believed to sustain jurisdiction are *Helvering* v. *American Dental Company*, 318 U. S. 322; *Commissioner* v. *Heininger*, 320 U. S. 467; *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281.

Opinions Below

The opinion of the Circuit Court of Appeals for the Second Circuit was rendered on July 19, 1944. It is reported in 144 Fed. 2nd, 41 and is to be found on Pages 252 to 258 of the record herein. Rehearing was denied on August 8, 1944, and the mandate of the Court was entered on the same day. The memorandum decision of the Tax Court of the United States (April 20, 1943, Docket Nos. 111317, 111318; 111320, 111322) appears on Pages 85 to 93 of the record herein.

Summary Statement of Matter Involved

The above entitled consolidated proceedings involve deficiencies in federal income taxes for the years 1936 to 1940 assessed against the petitioners by the Commissioner of Internal Revenue. The amounts of the deficiencies are as follows:

	1936	1937	1938	1939	1940
Est. of Jerome Regensburg	$14,136.58	$10,305.53	$4,616.89	.....	$1,091.77
Melville E. Regensburg	9,873.15	9,108.40	3,491.27	.....	.....
Mortimer Regensburg	39,256.82	21,683.33	11,301.90	.....	2,369.14
Isaac Regensburg..	78,703.42	23,033.46	13,442.47	$1,280.53	9,014.23
Melville E. Regensburg & Sophy P. Regensburg	.....	.....	.....	.....	981.32

The assessment arose out of the Commissioner's determination that certain withdrawals on open account made by the petitioners from E. Regensburg & Sons, a corporation of which they were the principal stockholders, were taxable to them as distributions of corporate earnings under Section 115 of the I. R. C. The Tax Court of the United States sustained the Commissioner and was in turn sustained by the United States Circuit Court of Appeals for the Second Circuit.

There has never been any dispute as to the facts. Briefly stated, these are as follows: From the inception of the corporation in 1903, its officers, directors and principal stockholders, maintained individual open accounts with the corporation from which they made withdrawals from time to time and to which the corporation credited all salaries paid to them, dividends declared by the corporation, payments of cash or cash equivalent and interest on corporate notes. No other stockholders of the corporation made such withdrawals. The withdrawals were not in proportion to stock holdings and were made individually by the petitioners without concert of action. In 1934, the petitioners, the corporation and certain other stockholders who had not made any such withdrawals, entered into a written agreement whereby the petitioners agreed that if any one of them sold any of his stock in the corporation while indebted to the corporation, so much of the purchase price as would be necessary to discharge such debt would be paid to the corporation; or if the corporation were the purchaser, it would deduct the amount of the indebtedness from the purchase price, the shareholder to continue liable for the unpaid balance. The corporation was expressly granted a lien against petitioners' stock for the amount of their indebtedness and the petitioners endorsed their stock in blank and deposited it with the corporation as collateral security. As

recently as 1939-40 they purchased additional stock which they similarly endorsed and deposited. In fixing the purchase price of this additional stock, the debit balances of the petitioners were treated as assets of the corporation.

Jerome Regensburg died on October 31, 1941; the corporation subsequently filed a claim against his estate for the amount of his indebtedness to the corporation, and the claim was accepted by the executrix and became a binding claim against his estate. Since that time, Isaac Regensburg, one of the other petitioners, has also died, and a similar claim against his estate has been filed by the corporation

The petitioners, Mortimer Regensburg, Melville E. Regensburg, and Isaac Regensburg who testified at the trial, stated that they were obligated to repay their debit balances and intended to do so.

Between 1903 and 1935, dividends were regularly declared at formal meetings of the board of directors, and the amount of the dividends payable to the stockholders indebted to the corporation was credited against their respective open accounts. No dividends were declared during the years 1936 to 1940. The corporation had an accumulated surplus from preceding years but it showed an operating loss in each of the years involved in these proceedings.

The corporation has at all times carried the debit balances in the open accounts as assets in the form of collateral loans or accounts receivable on its books, balance sheets and financial statements to credit agencies and banks and on its income tax returns. It at no time cancelled, compromised or forgave the indebtedness of any of the petitioners.

The Circuit Court, though observing that the evidence indicated that the withdrawals were loans and did not represent distribution of earnings, and stating clearly that it *would have sustained that conclusion had the Tax Court*

reached it, felt bound to sustain the contrary view, if, as it put it, the *inference* drawn by the Tax Court was *permissible*.

Questions Presented

1. Is the Circuit Court so limited in its appellate powers that it must sustain the decision of the Tax Court where there is no evidence to support it but merely a permissible inference against which reason and logic recoil?

2. Do withdrawals made by and charged to the personal accounts of individuals, officers, directors and stockholders of corporations, without concert of action or declaration, without relation to their respective stockholdings, secured by the deposit of their stock as collateral under an agreement evidencing their obligation for repayment, constitute a distribution of earnings within the meaning of Section 115 of the Internal Revenue Code?

Reasons Relied On for the Allowance of the Writs

1. The withdrawals were not dividends within the meaning of Section 115 of the Internal Revenue Code. A dividend is a distribution of earnings made by a corporation to its stockholders for their permanent use. It connotes affirmative action by the corporation by which it makes an outright, irrevocable payment to stockholders. Before there can be a taxable distribution, it is required that the sums in question be "unqualifiedly made subject to the demands of the taxpayer" (Reg. 94, Art. 115-1). Nothing like that occurred here. Instead, the corporation always treated the withdrawals as loans which it expected the taxpayers to repay. The taxpayers recognized their liability to repay the same, made payments on account thereof and deposited their stock to secure such repayment. The relationship of debtor and creditor existed between the tax-

payers and the corporation with respect to the withdrawals. The indebtedness created thereby can be enforced against the taxpayers at any time by the corporation or by any of its creditors by suit or by sale of the security deposited by the taxpayers.

2. The decision is in direct conflict with those of other Circuits, and there is no decision of the Second Circuit which supports it. It conflicts with the case of *Moses Cohen et al.* v. *Commissioner*, 77 Fed. 2nd 184 (C. C. A. 6) certiorari denied 296 U. S. 610, where upon a similar state of facts the Sixth Circuit said that it knew of no principle of law under which the custom of cash withdrawals through the usual drawing account, could give rise to the dignity of a distribution of corporate earnings without either action on the part of the corporation or some evidence of agreement among the shareholders that such withdrawals were to be treated as distributions of earnings.

It is also in direct conflict with the decision in *Harry Wiese* v. *Commissioner*, 93 Fed. 2nd 921 (C. C. A. 8) cert. den. 304 U. S. 562, where upon an analogous state of facts the Eighth Circuit said that the manner in which the withdrawals were recorded on the books and records of the corporation was controlling in determining the nature of the withdrawals, even though the corporation had an accumulation of profits in excess of the withdrawals and they were made by the sole stockholder of the corporation.

It is in conflict with the case of *Cohn* v. *Commissioner*, 121 Fed. 2nd 348 (C. C. A. 5) where the Fifth Circuit, on a similar state of facts, declared that although the stockholder making the withdrawals gave no note to evidence the indebtedness and paid no interest thereon, the withdrawals were to be treated as loans when made and did not become dividends until declared to be such by the corporation.

It is also in conflict with the case of *Allen* v. *Commissioner*, 117 Fed. 2nd 364 (C. C. A. 1) where the First Circuit held that withdrawals made under similar circumstances became taxable distributions of earnings only when charged off on the corporation's books.

3. The Circuit Court has misconceived and misapplied the principles governing the finality of decisions of the Tax Court on appeals therefrom. It followed *Dobson* v. *Commissioner* (320 U. S. 489), disregarding *Commissioner* v. *Heininger* and *Security Flour Mills Co.* v. *Commissioner*. It is at odds with views of other Circuit Courts of Appeals—*Repplier Coal Co.* v. *Commissioner*, 140 Fed. 2d 554 (C. C. A.-3, Feb. 19, 1944); *Lewis* v. *O'Malley*, 140 Fed. 2d 735 (C. C. A.-8, Jan. 3, 1944); *Denholm and McKay* v. *Commissioner*, 139 Fed. 2d 545 (C. C. A.-1, Jan. 7, 1944); *William R. Wallace, Jr., Ina Clair Wallace* v. *Commissioner* (C. C. A.-9, July 17, 1944). The differences in view of the various Circuit Courts concerning their right to review and reverse decisions of the Tax Court having no reasonable basis in fact or in law, should be resolved once and for all by this Court.

Wherefore, petitioners respectfully pray that writs of certiorari issue out of and under the seal of this Honorable Court directed to the Court of Appeals of the Second Circuit, commanding that Court to certify and send to this Court for its review and determination on a day certain therein to be named, a full and complete transcript of the record and of the proceedings in these cases numbered and entitled on its docket Nos. 18952 to 18956, inclusive, *Regensburg* v. *Commissioner of Internal Revenue*, and that such decision of the Circuit Court of Appeals for the Second Circuit may be reviewed by this Honorable Court, and that

the petitioners may have such other and further relief in the premises as to this Honorable Court may seem mete and just.

Dated November 1st, 1944.

ARTHUR B. HYMAN,
Counsel for Petitioners.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

Point I

On the Facts, the Inference That the Withdrawals Were Dividends, Is Not a Permissible One

Whether the withdrawals in the instant case were loans or constituted a distribution of earnings by the corporation was a question of law. The Circuit Court was not bound to sustain the conclusion of the Tax Court, which it is clear it would not have reached either originally or upon an unhampered review, merely because an inference, not determinative or conclusive, made by the Tax Court, was considered permissible.

The decision of the Circuit Court of Appeals can only be reconciled with a misconception of the views of this Court concerning the breadth of its powers. This misconception stems from what was said in the *Dobson* case, supra. While no direct reference to that case is made in the opinion, it is abundantly clear that its fancied impact was responsible. It is a misconception to assume that an appeal lies to the Circuit Court of Appeals as a matter of right but that it is powerless to reverse where the evidence is irreconcilable with the conclusion reached. Neither *Wilmington Trust Company* v. *Helvering*, 316 U. S. 164 nor any other case so restricts the power of that Court. The views expressed in the *Dobson* case have since been severely limited and other Circuits have not found it an obstacle to review and reversal, *Wallace* v. *Commissioner*, supra; *Commissioner* v. *Heininger*, supra; *Security Flour Mills Co.* v. *Commissioner*, supra. The Circuit Court abdicated its functions completely when it held itself bound to sustain a decision which had no support whatever in the evidence.

The inference drawn by the Tax Judge that the withdrawals were ordinary dividends, which the Circuit Court found to be a permissible one, has produced a result so illogical and so repugnant to the purpose of Section 115 of the Internal Revenue Code that we are impelled briefly to examine it to determine whether it was in fact a permissible one, assuming for that purpose only that if it was, the Circuit Court was bound to sustain it notwithstanding that no trier of the facts could reasonably draw it.

Whether an inference is permissible depends not on whether it might have been drawn from any single fact but whether it can be sustained in the face of all the facts. Applying this test, it is plain that the Tax Judge's inference, which the Circuit Court refused to reverse, could have been properly drawn only if the evidence to the contrary found in the record was not there, and that in the light of such evidence, it was neither permissible nor reasonable.

The Circuit Court found that the facts presented are "consistent with the theory of loans". They are *more* than merely consistent with such a theory. They are inconsistent with any other theory and a contrary inference cannot logically be drawn.

The withdrawals made by the individual stockholders had not the remotest relation to their holdings, were made without concert of action among themselves and without any direct authorization by the corporation. Is it a permissible inference that the corporation was making a distribution of earnings? Is it a permissible inference that stockholders who were being injured by these withdrawals would have tolerated a distribution of earnings so inimical to their interests?

The corporation recorded the withdrawals as loans and represented them to be such upon financial statements furnished to banks and to trade associations as a basis for credit. Is it a permissible inference that the corporation

was making a distribution of earnings and falsifying its records?

Is it a permissible inference that the agreement of 1934 entered into with the stockholders to insure repayment of these loans, and under which the corporation demanded and received a deposit of the petitioners' stock as collateral security, had some purpose not to be found in or implied from its clear language or established by extrinsic evidence?

Is it permissible to infer that the taxpayers would have deposited their stock as collateral and from time to time have made payments on account of the withdrawals, one of $15,000 by each taxpayer in 1939, if they really looked upon the withdrawals as permanent distributions of earnings imposing no obligation of repayment?

Is it permissible to infer that the petitioners, as recently as 1939-40, would have purchased additional shares of E. Regensburg & Sons for a total of $120,000 if their debit balances, which were included as assets of the corporation in fixing the purchase price, were not bona fide, enforcible obligations? Or that they would immediately have deposited this additional stock with the corporation as collateral security for their indebtedness if there were in fact no indebtedness owing by them?

Is it a permissible inference that the executrix or heirs of Jerome Regensburg would subject his estate to a debt of $250,000 if the withdrawals which were the basis of the corporation's claim against the estate were in fact dividends? May the impelling force and effect of the filing of this claim in due course and its acceptance be extinguished because Divine Providence did not call Jerome sooner? Is the inference permissible that the institution of these proceedings, involving an alleged liability of $30,000, could have impelled the executrix to submit to and honor a claim of $250,000? If Jerome's withdrawals were

dividends, would not his executrix not only have rejected the claim, but have proceeded to compel the distribution to which, as a stockholder, Jerome would have been entitled if distributions were in fact being made?

It is a misnomer to speak of a permissible inference in connection with the decision of the Tax Court. What it did was to reach a conclusion of law upon all the facts based upon an inference which it drew concerning one or two purely incidental matters—inferences, by the way, which were not only unsupported but directly contrary to the evidence.

We wish to present a graphic picture of the injustice to the taxpayer which results from the supposed limitation upon the right to review tax cases: Although proceedings before the Tax Court are *de novo* and not by way of certiorari which would bring up for review the evidence and other proceedings before the Commissioner, and although all such evidence and proceedings before the Commissioner are held by that Court to be strictly irrelevant, it nevertheless treats the determination of the Commissioner as being presumptively correct, challenges the taxpayer to prove the contrary and then examines the evidence presented by the taxpayer to determine whether or not it is sufficient to overbear the presumption. While this practice cannot be legally justified, as pointed out by the New York Court of Appeals, (*Magna* v. *Hegeman Harris Company*, 258 N. Y. 82; *People ex rel Wallington Apts.* v. *Miller*, 288 N. Y. 31), it nevertheless persists. When a case reaches the Circuit Court of Appeals another presumption confronts the taxpayer, that is, the presumption that the determination of the Tax Court is correct coupled with what the Circuit Court of Appeals seems to think is a limitation upon its right to determine whether that presumption is justified. It is apparent, to use the vernacular, that when the Commissioner of Internal Revenue makes an *ex*

parte determination, without any evidence whatever or upon evidence, the character or weight of which is unknown, the taxpayer has two strikes on him and he has never had an independent review of the evidence.

Departure from fundamental principles in a particular case invariably brings in its wake, as it has in this case, the most serious and illogical consequences and leads to chaos. A glance at the consequences of the decision which we ask this Court to review points up the argument.

These withdrawals appear on the books of the corporation as assets and upon its balance sheets and credit statements to banks and agencies as assets. The taxpayers admit that they owe the money and intend to repay it. Their stock is deposited as collateral security for such repayment. But the Tax Court has said that the withdrawals were dividends and not loans; that the taxpayers do not owe the money to the corporation; and yet it is clear that they have no possible defense against the enforcement of the claims by the corporation, and that these claims must remain as corporate assets. The estates of Isaac and Jerome Regensburg must be valued for estate tax purposes. Claims for unpaid debit balances have been filed by the corporation against those estates. How is the Commissioner to value the stock of E. Regensburg & Sons? Can he by any stretch of principle disallow the liabilities of the decendents when he comes to value the stock securing them?

When consequences such as we have pointed out flow from a departure from principles that are ingrained in our jurisprudence, such a departure is intolerable. The pursuit of revenue does not justify it.

The decision of the Circuit Court extends beyond reasonable bounds the limitations upon appellate power in tax appeals. Its affirmance of the decision of the Tax Court completely emasculates principles of corporate law which until now have received general recognition by Bench and Bar.

We urge this Court to grant certiorari in order that, in the interest of the true administration of the law, both questions presented by this petition may be resolved.

Dated November 1st, 1944.

ARTHUR B. HYMAN,
Counsel for Petitioners.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

Sec. 22. Gross Income.

(a) *General Definition.*—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(d) *Distributions by Corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * * *

Sec. 115. Distributions by Corporations.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

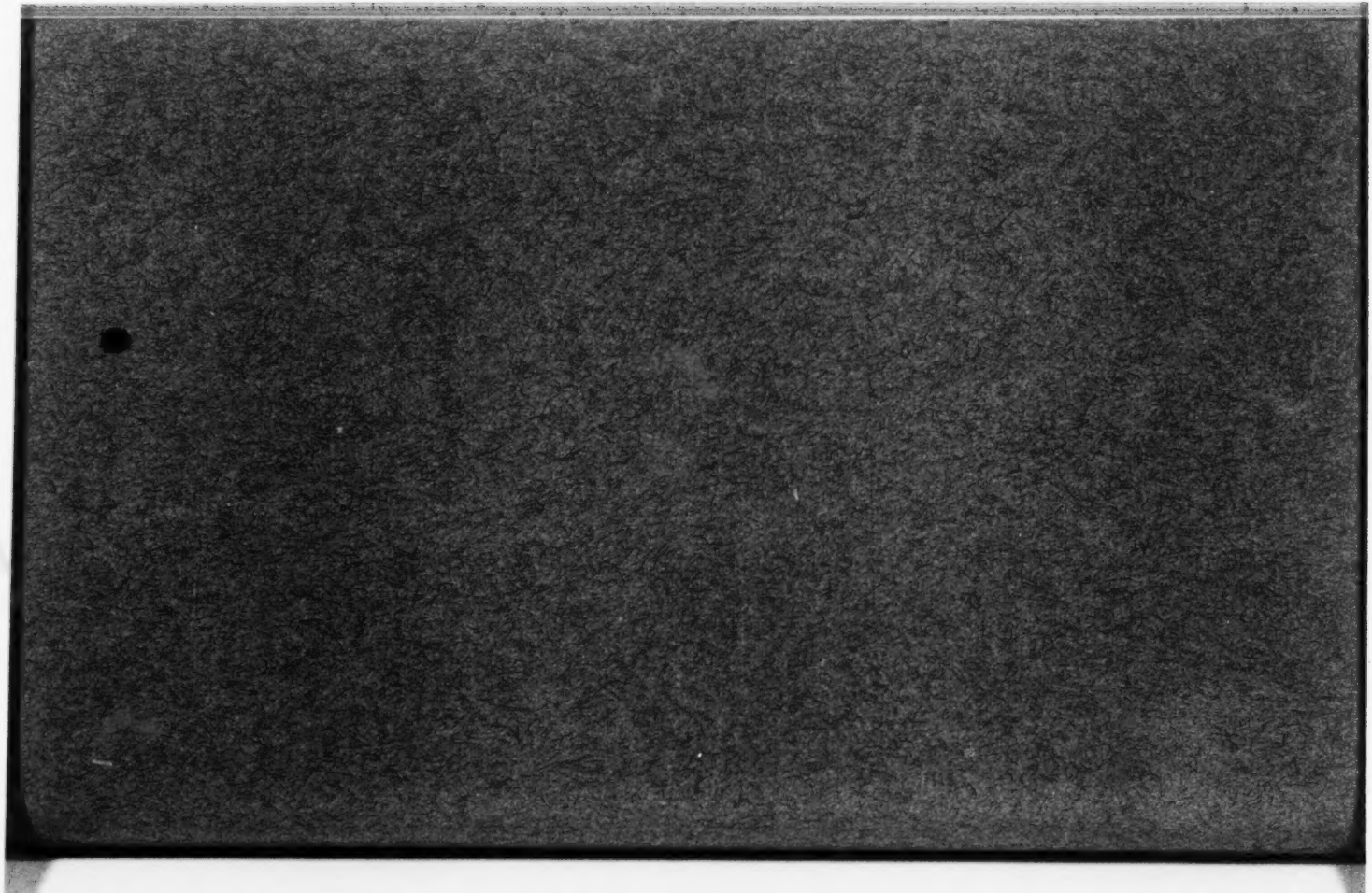
(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

The Corresponding sections of the Revenue Act of 1938, c. 289, 52 Stat. 447, and of the Internal Revenue Code are substantially the same as the above sections of the Revenue Act of 1936, except that Section 22 (d) of the Revenue Act of 1936 appears as Section 22 (e) of the Revenue Act of 1938 and the Internal Revenue Code.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> Art. 115-1. *Dividends.*—The term "dividend" for the purpose of Title I * * * comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of either
>
> (1) earnings or profits accumulated since February 28, 1913, or
>
> (2) earnings or profits of the taxable year computed without regard to the amount of the earnings or profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.
>
> The earnings or profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.
>
> A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands.
>
> * * * * * * *

Article 115-1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, and Section 19.115-1 of Treasury Regulations 103, promulgated under the Internal Revenue Code, are substantially the same as the above article of Treasury Regulations 94.



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In the Supreme Court of the United States

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ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 85–93) is not reported. The opinion of the Circuit Court of Appeals (R. 252–258) is reported in 144 F. 2d 41.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on August 8, 1944 (R. 267–271). A petition for rehearing was denied on August 8, 1944 (R. 266). The petition for writs of certiorari was filed on November 1, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in sustaining the Tax Court's finding that withdrawals of ac-

cumulated earnings of a family corporation by its principal stockholders, made in the form of open account loans, were in fact dividend distributions as defined in Section 115 of the applicable Revenue Acts.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions appear in the Appendix, *infra*, pp. 16–18.

STATEMENT

E. Regensburg & Sons is a New York corporation, organized in 1903 to manufacture and deal in tobacco products. It was the successor of a partnership conducted by Edward Regensburg and his five sons; all of the corporation's securities, consisting of 1,000 shares of $100 par value stock and $223,150.36 interest-bearing notes, were issued to them. The father died in 1910. The petitioners include three of the sons, Melville, Mortimer and Isaac, and the estate of Jerome, another son. The remaining petitioner, Sophy Regensburg, is the wife of Melville, with whom she filed a joint return for 1940. (R. 85–86.) The five companion cases involve identical issues. They were consolidated for hearing both before the Tax Court (R. 6) and the Circuit Court of Appeals (R. 250).

Since the father's death, his five sons have been the principal shareholders and the officers and directors. From September 1931 to Novem-

ber 1941, they owned together all but 75 shares which were held by relatives, and after November 1941, they owned all but 35 shares. From 1936 to 1939, Mortimer and Isaac each owned 264 shares, Jerome owned 174 shares, and Melville and the fifth brother, Bellette, who is not a petitioner, each owned 114 shares. In December 1939, Mortimer bought 17½ shares, and in October 1940, the other four brothers bought another 17½ shares from the relatives; each block of 17½ shares had a book value of about $74,000 and was purchased for $60,000. (R. 86, 88.) The four petitioning brothers are ordinarily hereinafter referred to as the taxpayers.

From the organization of the corporation in 1903, taxpapers maintained with the corporation individual open accounts in which withdrawals were debited and in which salaries, dividends declared, and interest due on the corporation's notes held by taxpayers were credited (R. 87). The withdrawals were made by taxpayers at pleasure and without previous consultation among them (R. 89, 91). The amounts withdrawn or otherwise debited to each taxpayer were greater than the amounts credited to him so that, except in a few early years, the debit balances kept increasing (R. 88). The total withdrawals and credits of taxpayers from 1903 to the end of 1940, and their net debit balances as of the end of 1940, were as follows (R. 90):

	Cash withdrawn or paid on his behalf by corporation 1903–1940	Salary	Credits Dividends	Miscellaneous	Total net debit balance Dec. 31, 1940
Mortimer	$2,560,845.08	$1,140,900.03	$555,000.00	$115,556.87	$749,388.11
Isaac	3,511,566.80	1,140,900.04	555,000.00	137,994.95	1,677,671.81
Jerome	1,535,028.03	861,595.99	394,800.00	73,578.83	250,053.21
Melville	1,401,400.85	752,645.84	211,650.00	38,185.40	398,919.61

The company's by-laws provided that "The Board of Directors shall, by vote, declare dividends from the surplus profits of the Company whenever in their opinion the condition of the company's affairs will render it expedient for such dividends to be declared by them" (R. 86).

Throughout the corporation's history, dividends were declared and salaries fixed at meetings of the board of directors formally called for the purpose. From 1904 to and including the year 1935 (the year prior to the taxable years here involved), dividends totaling $2,270,000 were declared. With the exception of 1930, substantial dividends were declared in each year from 1923 to 1935; and in each of the years 1933, 1934 and 1935 dividends in the amount of $200,000 were declared. (R. 86–87.)

From 1936 to 1940, the taxable years here involved, no dividends were declared and the corporation reported none in its income tax returns (R. 87). Taxpayers continued, however, to make withdrawals during those years in excess of amounts credited to their accounts, and their net

debit balances increased. Mortimer's net debit balance at the end of 1935 was $580,647.88 and had grown to $749,388.11 by the end of 1940; Isaac's net debit balance at the end of 1935 was $1,407,-196.16 and had grown to $1,677,671.81 by the end of 1940; Jerome's net debit balance at the end of 1935 was $167,171.30 and had grown to $250,-053.21 by the end of 1940; and Melville's net debit balance at the end of 1935 was $327,440.61 and had grown to $398,919.61 by the end of 1940. (R. 88.)

The shareholdings and the net withdrawals by taxpayers during the taxable years were as follows (R. 88):

		1936	1937	1938	1939
Mortimer	264 Shares	$81,552.62	$50,216.13	$33,644.16	
Isaac	264 Shares	143,208.96	63,387.32	37,560.55	$5,405.25
Jerome	174 Shares	40,426.30	31,308.83	17,762.11	
Melville	114 Shares	32,663.16	30,002.31	14,526.08	

		1940	Total 1936–1940
Mortimer	281½ Shares	$5,774.59	$171,157.50
Isaac	268¾ Shares	20,913.57	270,475.65
Jerome	178¾ Shares	3,002.28	92,499.52
Melville and Sophy	118¾ Shares	3,061.30	80,252.85

The corporation had no current earnings during the taxable years but had an earned surplus during those years as follows (R. 86):

January 1, 1936	$4,855,067.25
December 31, 1936	4,781,207.08
December 31, 1937	4,599,165.83
December 31, 1938	4,425,437.34
December 31, 1939	4,266,930.67
December 31, 1940	4,183,133.15

The net withdrawals by taxpayers during the taxable years were distributions of earnings accumulated after February 28, 1913 (R. 88). No interest was accrued or paid on the withdrawals and no note or other evidence of indebtedness was given for the debit balances. Shareholders who were not officers or directors at no time made withdrawals or received any funds from the corporation except to the extent that dividends were formally declared. The withdrawals from the corporation constituted practically all of taxpayers' income, and taxpayers owned no other income-producing property. (R. 89.)

The corporation at all times kept complete account of withdrawals made by petitioners and all credits, carrying the excess of withdrawals over credits as accounts receivable. It treated such accounts receivable as assets and included them on its income tax returns, its balance sheets, and in financial statements to credit agencies and to banks which honored its trade acceptances and extended credit to it. It at no time cancelled, compromised or forgave taxpayers' debit balances. (R. 89.)

After 1910, the credits in each account consisted almost entirely of the fixed salaries and dividends (R. 88). In addition to these credits, the accounts of taxpayers show certain miscellaneous credits. In 1915, taxpayers' salaries were increased retro-

actively for the period 1910–1915 and the increase was ordered applied to their overdrafts up to December 31, 1915 (R. 87). In 1912, Isaac was credited with a cash contribution of $10,000, and in 1924 with a contribution of $15,000, neither of which was sufficient to cause a reduction in his net debit balances for those years. In 1939, the account of each taxpayer was credited with $14,912.66, his distributive share of their mother's credit balance on the corporation's books at the time of her death (R. 89). With the exception of these credits, taxpayers have made no repayments of their withdrawals (R. 92).

On October 8, 1934, all the shareholders made a formal agreement that if any of them should sell any of their shares while indebted to the corporation, so much of the purchase price as would be necessary to discharge such debt, without interest, would be paid to the corporation or, if the corporation were the purchaser, it would make such deduction from the purchase price. The shareholder would continue liable for any unpaid balance. The corporation was given a lien on the shares and the fact of the agreement was to be endorsed thereon. The stock so endorsed was delivered to the corporation. None of the taxpayers ever sold any shares of the corporation. (R. 89–90.)

At a meeting of the board of directors on May 31, 1938, salaries were reduced 25% and a resolution was adopted that "effective at once no withdrawals of cash for the purpose of loans to officers

be permitted" (R. 90). Withdrawals, however, continued as before, and the net debit balances were even larger in 1940 than they were in 1938 (R. 88).

On May 4, 1942, after the deficiency notices in these proceedings were sent, the corporation filed a claim against Jerome's estate for $251,277, representing "loans and advances" secured by collateral lien on his shares in the corporation. No objection was made to the claim by the widow-executrix and it has been recognized as a duly proven and binding claim. (R. 90, 93.)

In their income tax returns for 1936 to 1940, inclusive, taxpayers did not report any of their withdrawals from the earned surplus as income. The Commissioner determined that the net withdrawals were dividend distributions and computed deficiencies accordingly. (R. 24–31, 37–42, 48–55, 60–68, 73–76.) The Tax Court sustained the Commissioner's determination (R. 94–98) and the Circuit Court of Appeals affirmed (R. 267–271).

ARGUMENT

The decision below is controlled by established principles governing the scope of review of Tax Court decisions, and taxpayers do not, and cannot, assert that this case presents an important question.

1. Whether a withdrawal of corporate earnings by stockholders constitutes a dividend or a loan does not, as taxpayers assert (Pet. 9, 12), present a question of law. It is settled that this

narrow issue is one of fact, and turns upon whether it was intended that the withdrawal be repaid. If the withdrawal is intended as a permanent distribution, it is a dividend as defined in Section 115 of the applicable Revenue Acts (Appendix, *infra*, pp. 16–17) notwithstanding that the formalities of a dividend declaration have not been observed, that the withdrawal is recorded on the corporate books as a loan, that it is not in proportion to stockholdings, or even that some of the stockholders do not participate in it. *Chattanooga Sav. Bank* v. *Brewer*, 17 F. 2d 79 (C. C. A. 6th), certiorari denied, 274 U. S. 751; *Christopher* v. *Burnet*, 55 F. 2d 527 (App. D. C.); *Hadley* v. *Commissioner*, 36 F. 2d 543 (App. D. C.); *Anketell Lumber & Coal Co.* v. *United States*, 1 F. Supp. 724 (C. Cls.); *P. Garvan, Inc.* v. *Eaton*, 20 F. 2d 422 (D. Conn.); *Meyer* v. *Commissioner*, 45 B. T. A. 228; *Kinnear* v. *Commissioner*, 36 B. T. A. 153, dismissed, 95 F. 2d 997 (C. C. A. 9th); *Murchison* v. *Commissioner*, 32 B. T. A. 32; *Marshall* v. *Commissioner*, 32 B. T. A. 956; cf. *Lincoln Nat. Bank* v. *Burnet*, 63 F. 2d 131 (App. D. C.); *Faris* v. *Helvering*, 71 F. 2d 610 (C. C. A. 9th), certiorari denied, 293 U. S. 584; *Phelps* v. *Commissioner*, 54 F. 2d 289 (C. C. A. 7th), certiorari denied, 285 U. S. 558; *Clark* v. *Commissioner*, 84 F. 2d 725 (C. C. A. 3d); see 1 Mertens, Law of Federal Income Taxation, Sec. 9.25. On the other hand, where it is intended that the with-

drawal be repaid, it is a loan and becomes a taxable dividend only if the corporation should later cancel the debt. *Wiese* v. *Commissioner,* 93 F. 2d 921 (C. C. A. 8th), certiorari denied, 304 U. S. 562; *Cohen* v. *Commissioner,* 77 F. 2d 184 (C. C. A. 6th), certiorari denied, 296 U. S. 610; *Commissioner* v. *Cohen,* 121 F. 2d 348 (C. C. A. 5th); *Allen* v. *Commissioner,* 117 F. 2d 364 (C. C. A. 1st); cf. *Waggaman* v. *Helvering,* 78 F. 2d 721 (App. D. C.), certiorari denied, 296 U. S. 618; *Fitch* v. *Helvering,* 70 F. 2d 583 (C. C. A. 8th).

Taxpayers rely (Pet. 5) on the provision in Article 115–1 of Treasury Regulations 94 (Appendix, *infra,* pp. 17–18) that a taxable distribution "shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands", but this provision has no bearing on the issue presented. It relates solely to the reporting period, and requires taxable dividends to be reported in the year constructively received, though not actually then received. The question here is not when the corporate earnings were received by taxpayers, for they admittedly were withdrawn and therefore unqualifiedly received during the taxable years, but whether they were received as dividends or loans. The intention of the parties, a matter traditionally within the field of fact finding, is determinative of the latter question.

2. The decision below is not, as taxpayers al-

lege (Pet. 6–7), in conflict with *Cohen* v. *Commissioner,* 77 F. 2d 184 (C. C. A. 6th), certiorari denied, 296 U. S. 610; *Wiese* v. *Commissioner,* 93 F. 2d 921 (C. C. A. 8th), certiorari denied, 304 U. S. 562; *Commissioner* v. *Cohen,* 121 F. 2d 348 (C. C. A. 5th); or *Allen* v. *Commissioner,* 117 F. 2d 364 (C. C. A. 1st). In those cases, it was held that withdrawals of corporate earnings which were originally loans became taxable dividends when the loans were later cancelled. It is significant that in each of them the Board (now the Tax Court) had found that the withdrawals were in fact loans in the first instance; and in each of them the Circuit Court of Appeals held that since the Tax Court's decision was supported by substantial evidence it would not be disturbed. In the instant case, the Tax Court found on the basis of all the evidence that taxpayers did not intend to repay their withdrawals and that consequently they were dividend distributions. This finding, since it is supported by substantial evidence, is likewise conclusive on review.

3. Taxpayers contend (Pet. 5, 9–13) that there is no evidence to support the Tax Court's inference that the withdrawals were here intended as permanent distributions. This contention is, of course, incompatible with their simultaneous insistence (Pet. 9, 12) that whether the withdrawals were intended to be dividends or loans presents a legal question. Moreover, the argument rests upon only

a portion of the record and ignores the evidentiary basis upon which the Tax Court reached its conclusion, and upon which the court below relied (R. 256–257) in sustaining it. The record discloses that taxpayers, who owned practically all the stock and were the directors and officers of the corporation, for over forty years had consistently engaged in the practice of withdrawing the corporate profits at pleasure, irrespective of the amounts of dividends declared or salaries credited to their accounts; that the excess of withdrawals over credits steadily increased each year, including the taxable years; that no note or other evidence of indebtedness was ever given for the excess of withdrawals over credits; that the debit balances had no maturity date but ran on indefinitely; that no interest was charged; that with the exception of two relatively minor payments by one of the taxpayers in 1912 and 1924, neither of which was sufficient to cause a reduction in his net debit balance for those years, no cash repayments were made; that no attempt was ever made by the corporation to collect the debit balances but that on the contrary they mounted each year; and that taxpayers had no outside means of repayment (R. 85–92, 150–151, 175–176, 183–190). Certainly these uncontroverted facts afforded a substantial basis for the Tax Court's inference that the excess of withdrawals over credits in the taxable years represented per-

manent distributions of the corporate earned surplus rather than temporary loans.

4. There is no merit in taxpayers' statement (Pet. 7, 9–13) that the court below misapplied the principles governing the scope of review of Tax Court decisions. The argument assumes that the court below was required to substitute its own inference for that of the Tax Court by attaching conclusive weight to those facts which pointed to a loan. But it is axiomatic that "It is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, to draw inferences from the facts, and to choose between conflicting inferences". *Wilmington Co.* v. *Helvering,* 316 U. S. 164, 168; see also *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231; *Helvering* v. *Kehoe,* 309 U. S. 277, 279; *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, rehearing denied, 305 U. S. 669. Taxpayers' reliance (Pet. 7, 9) upon *Commissioner* v. *Heininger,* 320 U. S. 467, and *Security Mills Co.* v. *Commissioner,* 321 U. S. 281, is misplaced; in both those cases this Court reaffirmed the principle that in the absence of a mistake of law the Tax Court's decision is entitled to finality. The court below correctly held (R. 256–257), in accord with that principle, that reversal of the Tax Court's decision was not warranted merely because an opposite inference might have been drawn from the facts.

CONCLUSION

Neither a conflict of decisions nor a question of general importance is presented. The petition should therefore be denied.

Respectfully submitted.

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NOVEMBER 1944.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * *

(d) *Distributions by Corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made

during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

The corresponding sections of the Revenue Act of 1938, c. 289, 52 Stat. 447, and of the Internal Revenue Code are substantially the same as the above sections of the Revenue Act of 1936, except that Section 22 (d) of the Revenue Act of 1936 appears as Section 22 (e) of the Revenue Act of 1938 and the Internal Revenue Code.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 115–1. *Dividends.*—The term "dividend" for the purpose of Title I * * * comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of either

(1) earnings or profits accumulated since February 28, 1913, or

(2) earnings or profits of the taxable year computed without regard to the amount of the earnings or profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.

The earnings or profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is

unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands.

* * * * *

Article 115–1 of Treasury Regulations 101, Promulgated under the Revenue Act of 1938, and Section 19.115–1 of Treasury Regulations 103, promulgated under the Internal Revenue Code, are substantially the same as the above article of Treasury Regulations 94.

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